Saskatchewan

Rate Review Panel

Report to the Minister of Crown Investments Corporation on:

The Proposal from SaskEnergy for a Change in the Natural Gas Commodity Rate

December 14, 2001

102-02442/

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Introduction

The Saskatchewan Rate Review Panel (the "Panel") has been asked by the Government of Saskatchewan to review Crown corporations' requests for rate changes for SaskEnergy, SaskPower and SGI - AutoFund.

The Panel consists of Bob Lacoursiere (Chair), Jack Boan (Vice Chair), Tracey Bakkeli, Jo-Ann Carignan-Vallee, Sheldon Craig and Joan Meyer. Each member of the Panel has been appointed until July 25, 2002.

MANDATE

In its general mandate, the Panel is instructed to conduct reviews and provide opinions on the fairness and reasonableness of proposed Crown corporation rate changes referred by the Minister of Crown Investments Corporation, considering the interests of the customer, the corporation and the public.

In conducting its reviews, the Panel is required to:

- receive a rate change submission from a Crown corporation;
- establish procedures for conducting the review and ensure that these procedures are made available to the public;
- engage the services of a consultant(s) to assist the Panel in its review of the fairness and reasonableness of the proposed rate change;
- make available to the public, prior to holding public meetings, the Crown corporation rate change submission, with the exception of commercially sensitive information;
- hold public meetings and provide appropriate notification to the public of the date and location of public meetings, including any rules for public participation and Crown corporation participation;
- provide members of the public with the opportunity to review and comment on the proposed rate changes to the extent reasonably allowed by the mandate of the Panel and by the schedule according to which the Panel is required to complete its work and provide its report to the Minister of Crown Investments Corporation;
- receive presentations of the consultant(s) or the Crown corporation, review any written submissions and receive comments from the public;
- prepare a report on the Crown corporation rate change submission for the Minister of Crown Investments Corporation after considering the material received from the Crown corporation, the consultant(s), the public and its own analysis:
    - where the Panel determines the rate changes as proposed are fair and reasonable, recommend that the changes be implemented; or,
    - where the Panel determines the rate changes are not fair and reasonable as proposed, recommend that the rate changes be adjusted providing reasons for this conclusion;

- provide its report respecting the proposed rate changes to the Minister of Crown Investments Corporation on a date set out in or within any time period after having received the rate change submission that is contained in the specific terms of reference for particular Crown corporation rate reviews; and,
- make its report available to the public.

TERMS OF REFERENCE

On October 12, 2001, the Panel was instructed to conduct a review of the SaskEnergy proposal for a change in the natural gas commodity rate.

With respect to the proposal for the natural gas commodity rate, the Panel was instructed to consider the reasonableness of the proposed change in the context of:

- SaskEnergy's anticipated cost of gas for the effective term;
- the Gas Purchase Contracts entered into by SaskEnergy for the supply of gas;
- the amounts SaskEnergy pays for the transportation of gas;
- the natural gas commodity market conditions at the time of SaskEnergy's contractual commitments; and,
- the disposition of the balance of the Gas Cost Variance Account.

In conducting the review, the Panel was instructed to take as given:

- the current operating rate structure;
- the approved capital allocation, annual rate of return target, rate base, and corporate policies;
- the existing service level; and
- the cost of service methodology and resulting study, which allocates SaskEnergy costs between the various rate classes.

The Panel was instructed to include in its report an explanation of how, in its opinion, implementation of the Panel's rate recommendations will allow SaskEnergy to achieve the performance inherent in the parameters outlined above, where the Panel's recommendations are different from SaskEnergy's proposed rate changes.

The Panel was instructed to present its report to the Minister of Crown Investments Corporation by December 14, 2001 (see Appendix A).

Proposal by SaskEnergy – Natural Gas Commodity Rate

The SaskEnergy proposal is for a reduction in the natural gas commodity rate.

NATURAL GAS COMMODITY RATE

SaskEnergy charges customers for the cost of natural gas used. This charge appears separately on a customer's bill and was established at a rate of 23.38 cents per cubic metre ($6.30 per GigaJoule (GJ)) effective June 1, 2001.

The SaskEnergy proposal is to decrease this rate to 20.14 cents per cubic metre ($5.44 per GJ) to:

- return the $10.1 million projected accumulation in the Gas Cost Variance Account (GCVA) to customers; and
- reduce the commodity rate to reflect lower costs of the price of gas for the period November 1, 2001 to October 31, 2002.

Under the SaskEnergy proposal, the new rate would apply to natural gas effective November 1, 2001. SaskEnergy did not request any changes to either the Basic Monthly or Delivery Charges.

SaskEnergy Application
Impact of Gas Consumption Charge of 20.14 cents per cubic metre
Effective November 1, 2001*

Rate Class	Average Annual Decrease**	Small Usage Bill Impact **	Large Usage Bill Impact **
Residential	$112 (-10%)	$65 (-9%)	$170 (-10%)
Farm	$138 (-10%)	$89 (-9%)	$194 (-10%)
General Service II	$428 (-10%)	$162 (-10%)	$2,592 (-11%)
General Service III	$6,406 (-11%)	$3,240 (-11%)	$21,384 (-11%)

* **Excludes Municipal Payments and GST charges.**
** **Percentage impact calculated on total of basic, delivery (volume based) and gas consumption charges.**

Cabinet approved SaskEnergy's proposal on an interim basis effective November 1, 2001, pending the receipt of a recommendation from the Panel.

The Review Process

PUBLIC CONSULTATIONS

In reviewing the SaskEnergy proposal, the Panel received comments and suggestions from individuals and groups throughout Saskatchewan through a public consultation process including:

- two public meetings;
- use of a toll-free telephone message line;
- receipt of letters;
- receipt of messages by facsimile; and,
- receipt of electronic message correspondence.

The methods available for public discussion were advertised in daily newspapers and in weekly newspapers. In addition, clips were played on local radio stations.

Panel members were also involved in various media interviews.

A copy of the SaskEnergy rate proposal was available to the public at SaskEnergy offices, at the public meetings and on the Internet.

The public meetings were held November 22 in Saskatoon and November 27 in Regina.

The meetings included:

- an introduction by the Chair with an explanation of the proceedings and the Panel's mandate for the review;
- an overview by SaskEnergy of its request;
- an opportunity for submissions by individuals or organizations that had indicated an interest in addressing the Panel; and,
- an opportunity for questions or comments from the floor.

PRESENTATIONS

As required in its mandate, the Panel received presentations and information from officials of SaskEnergy and from the Panel's consultant at several points throughout the review process to:

- develop an understanding of the proposed rate change;
- understand the analyses prepared for the Panel; and,
- develop recommendations.

CONSULTANT

In conducting its review, the Panel engaged the services of a consultant to examine and advise on the reasonableness and fairness of the SaskEnergy proposal.

The British Columbia Utilities Commission (BCUC) was contracted to provide consulting services to the Panel. Staff assigned to the review by the Commission have extensive experience in utilities regulation.

Panel Conclusions and Recommendations

The Panel met with the consultant and subsequently sought additional information from SaskEnergy officials on the rate proposal.

The consultant prepared a report and assessment of the SaskEnergy submission (attached as Appendix B).

Load Forecast

All differences between forecast and actual costs of purchasing gas accumulate to the Gas Cost Variance Account (GCVA). Consequently variances between forecast and actual volumes are not as critical as they might be in a delivery charge rate application. Based on a limited review and comparison to SaskEnergy's forecast for 2000/01, the consultant indicated the 2001/02 forecast should be accepted as reasonable.

The Panel concurs with the consultant's assessment.

Supply Portfolio

The consultant noted Saskatchewan consumers benefit greatly from the available storage in close proximity to load requirements. The consultant also noted SaskEnergy had extensively (84 percent) hedged its purchases by buying call options to set a cap price.

SaskEnergy uses financial hedging strategies to provide customers with upward price protection but allow downward price participation. For 2001/02 SaskEnergy extensively hedged purchases by buying call options to set a cap price. Some of the call options were associated with the sale of put options to provide a 'costless' collar for a portion of the hedges. Premiums from the sale of put options offset some of the costs of the call options but the put options establish a floor price (ie. set a minimum price) for related gas purchases.

The Panel particularly notes the consultant's observations regarding the preferred time to review the composition of a supply portfolio is before gas supplies are contracted. The consultant reiterated greater oversight of SaskEnergy's gas contracting and price risk management strategy would be preferable prior to implementation and recommended the Panel implement such a process for SaskEnergy for the 2002/03 gas contract year.

The Panel notes that earlier involvement may better allow it to meet its mandate to balancing the needs of the customer, the Crown corporation and the public.

The Panel recommends SaskEnergy file with the Panel its Gas Supply and Price Risk Management Plan for 2002/03, setting out the Utility's strategy for buying a sufficiently reliable supply of gas at the lowest overall cost prior to entering into significant new supply contracts or hedges for this period.

Forecast Cost of Gas

The Panel notes the consultant accepts the forecast Cost of Gas Sold as listed in the application as reasonable assuming an AECO (Alberta Energy Company) price of $3.00/GJ for 2001/02. However since filing, the consultant notes forward gas prices have increased to an average $3.74/GJ (AECO) and recommends this more recent forecast be used when setting 2001/02 rates.

The Panel concurs with the consultant's assessment.

Gas Cost Variance Account (GCVA)

Effective November 1, 1999, SaskEnergy introduced the use of a Gas Cost Variance Account (GCVA). The GCVA is used to ensure SaskEnergy does not earn a profit nor incur a loss on the supply of gas.

For example, if the rate established for natural gas consumption proves to be higher than the actual cost to SaskEnergy to purchase gas in the course of a year, the 'surplus' would accrue in the Gas Cost Variance Account and could be applied to reduce the gas consumption rate from the level it would otherwise be in subsequent periods.

Conversely, if the gas consumption charge in any gas year was inadequate to cover the actual cost of gas purchased in that year, the 'deficit' in the Gas Cost Variance Account would be added into the calculation of gas consumption charges in subsequent periods.

The GCVA had a debit balance of $75.9 million at the end of May 2001. Cabinet directed SaskEnergy to absorb this debit to create a zero account balance effective June 1, 2001. The rate application projected a credit balance of $10.1 million as of October 31, 2001. The consultant's report indicates SaskEnergy provided a revised forecast of approximately $11.3 million credit as of October 31, 2001.

In the application SaskEnergy projected a GCVA debit balance of $13.8 million at October 31, 2002 based on the proposed Gas Consumption Charge and a forecast AECO price of $3.00/GJ. An updated forecast adjusted this to a $12.5 million debit balance for the same period. Based on the more recent AECO forecast of $3.74/GJ, the debit balance increases to $18.3 million.

The consultant notes SaskEnergy appears to be administering the GCVA as anticipated. Because of the continued gas price volatility, the consultant recommends SaskEnergy change the contents of its quarterly report to include a forecast cost of gas, forecast revenue and GCVA balances for the next 12 month period. Use of a 12 month period should eliminate seasonal effects and would support a reasonable level of rate stability. The consultant also recommended the information be filed prior to the start of the 12 month period, using projections rather than actuals, to facilitate evaluation of existing rates in a timely manner.

The Panel recommends SaskEnergy amend the filing of its quarterly GCVA statement to report its balances 15 business days prior to the start of the period and to include forecast gas costs and revenue for the following 12 months.

Because gas prices continue to be volatile, the consultant also recommended the Panel and SaskEnergy develop guidelines to implement quickly changes to the Cost of Gas Consumption Charge in a more responsive manner than is currently possible. The Panel notes it would be desirable to have an expedited process to deal promptly with rapidly fluctuating natural gas prices. The Panel recognizes the expedited process may require amendments to the Panel's Minister's Order of July 27, 2000 to permit the Panel to operate in such a manner.

The Panel notes the revised GCVA forecast is significantly closer to the $20 million variance 'trigger point' than the original application projected. In other words, if the natural gas price volatility were such that the GCVA met or exceeded a $20 million deficit sooner than forecast, SaskEnergy would be required to submit an immediate rate increase for Panel review. The revised reporting system recommended above should allow SaskEnergy and the Panel to monitor the GCVA more closely. The Panel notes in the absence of an expedited process another review within a few months would not be desirable.

The Panel recommends the development of guidelines to permit SaskEnergy and the Panel to implement quickly a change to the natural gas commodity charge in response to changing circumstances, with the rate change to be reviewed subsequently if necessary.

Gas Consumption Charge

To reach a zero GCVA balance, a Gas Consumption Charge of 20.96 cents per cubic metre would be needed. This would result in a 7 percent reduction in customer bills rather than the 10 percent reduction proposed by implementation of the 20.14 cents per cubic metre rate. The Panel accepts the consultant's view the reduction is aggressive but still reasonable.

The Panel recommends the Gas Consumption Charge be set at 20.14 cents per cubic metre (or $5.44/GJ) for the 2001/02 gas year.

Effective Date

Cabinet approved SaskEnergy's requested implementation date of November 1, 2001 on an interim basis pending receipt of the panel's recommendation. SaskEnergy has implemented the new rate as directed.

The Panel recommends the requested Natural Gas Commodity rate changes be confirmed as effective November 1, 2001.

Summary

In summary the Panel recommends:

- the Natural Gas Commodity Charge be set at 20.14 cents per cubic metre (or $5.44/GJ) for the 2001/02 gas year; and
- the requested Natural Gas Commodity rate changes be confirmed as effective November 1, 2001.

The Panel also recommends:

- SaskEnergy file with the Panel its Gas Supply and Price Risk Management Plan for 2002/03, setting out the Utility's strategy for buying a sufficiently reliable supply of gas at the lowest overall cost prior to entering into significant new supply contracts or hedges for this period;
- SaskEnergy amend its quarterly GCVA filing to report its balances 15 business days prior to start of the period and include forecast gas costs and revenue for the following 12 months; and
- the development of guidelines to permit SaskEnergy and the Panel to implement quickly a change to the natural gas commodity charge in response to changing circumstances, with the rate change to be reviewed subsequently if necessary.

IMPACT ON CUSTOMERS

Customers will continue to benefit from the rate decrease. For example the average residential customer will see an annual decrease of 14 percent on their gas commodity charge. This will result in an overall bill reduction of about 10 percent or $112 per year. In addition customers will benefit from secondary impacts of reduced municipal payments, where applicable, and reduced federal GST charges on the lower monthly bill.

IMPACT ON SASKENERGY

With the revised forecast numbers, SaskEnergy will need to monitor closely the status of the GCVA, particularly if natural gas prices remain volatile. SaskEnergy's Gas Supply and Price Risk Management Plan will require continued review to ensure a reliable natural gas supply at the lowest possible overall cost.

IMPACT ON THE PUBLIC

The Panel's recommendation continues to recognize the volatility of natural gas prices.

Revenue to the municipalities collecting the Municipal Payment will experience reduced revenues commensurate with the lower rates.

It is the Panel's view the rate change recommended is fair and reasonable, considering the interests of the customer, the Crown corporation and the public.

Appendix A:
Minister's Order
SaskEnergy Natural Gas Commodity Rate Change

APPENDIX A

Schedule G:
SaskEnergy Natural Gas Commodity Rate Terms of Reference

Terms of Reference

The Saskatchewan Rate Review Panel is requested to conduct a review of SaskEnergy's interim rate decrease in its natural gas commodity rates which was implemented November 1, 2001. The Panel is requested to approve or provide recommendations for changing the rate for implementation on January 1, 2002.

The Panel shall provide an opinion of the fairness and reasonableness of SaskEnergy's proposed rate changes, considering the interests of the customer, the Crown Corporation and the public.

In conducting its review, the Panel will consider the following factors:

(A) The reasonableness of the proposed changes to the gas consumption rates in the context of:

1. SaskEnergy's anticipated cost of gas for the effective term;
2. the Gas Purchase Contracts entered into by SaskEnergy for the supply of gas;
3. the amounts SaskEnergy pays for the transportation of gas;
4. the natural gas commodity market conditions at the time of SaskEnergy's contractual commitments; and
5. the disposition of the balance of the Gas Cost Variance Account.

(B) In conducting its review, the Panel shall consider the following as given:

1. the current operating rate structure;
2. the approved capital allocation, annual rate of return target, rate base, and corporate policies;
3. the existing service level; and
4. the cost of service methodology and resulting study, which allocates SaskEnergy costs between the various rate classes.

The Panel will not publicly release or require SaskEnergy to publicly release commercially sensitive material including, but not limited to, its gas price hedging strategy and any details of its hedging or the gas purchase contracts.

However, the Panel may release the net effect of SaskEnergy's gas price hedging and gas purchase contracts.

The Panel must include in its report an explanation of how, in its opinion, implementation of the

Panel's rate recommendations will allow SaskEnergy to achieve the performance inherent in the parameters outlined in "B", where the Panel's recommendations are different from SaskEnergy's proposed rate changes.

The Panel will release, as part of its final report, the results of the review of SaskEnergy's rate request as conducted by an independent third party.

Conduct of the Review

The Panel will present its report to the Minister of Crown Investments Corporation no later than December 14, 2001.

MINISTER'S ORDER

Saskatchewan Rate Review Panel
SaskEnergy Natural Gas Commodity Rate Change

WHEREAS by an Order dated July 27, 2000, issued pursuant to Section 16 *of The Government Organization Act*, the Minister of Crown Investments Corporation appointed a Ministerial Advisory Committee known as the Saskatchewan Rate Review Panel;

AND WHEREAS that Order provides for specific terms of reference for particular Crown Corporation rate change reviews to be attached by further minister's order;

AND WHEREAS it is desirable to establish terms of reference for a SaskEnergy rate change review and to attach the Terms of Reference to the previously mentioned Minister's Order;

NOW THEREFORE, I hereby amend the said Order by attaching Appendix A affixed hereto as **"Schedule G: SaskEnergy Natural Gas Commodity Rate Terms of Reference"** to the said Minister's Order.

Dated at Regina, Saskatchewan this 12th day of October, 2001.

Maynard Sonntag
Minister of Crown Investments Corporation

Appendix B:
British Columbia Utilities Commission
Staff Review Report
to the Saskatchewan Rate Review Panel
December 2001

SASKENERGY INCORPORATED

NATURAL GAS DISTRIBUTION UTILITY

COMMODITY RATE APPLICATION
for
November 1, 2001 – October 31, 2002

STAFF REVIEW REPORT

December 10, 2001

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SASKENERGY INCORPORATED

Commodity Rate Application

November 1, 2001 – October 31, 2002

BCUC Staff Review Report

1.0 INTRODUCTION

1.1 SaskEnergy Application

SaskEnergy Incorporated ("SaskEnergy", the "Utility") filed an Application in October 2001 requesting a decrease in its Gas Consumption Charge for the 12-month period from November 1, 2001 through October 31, 2002 (the "Application"). SaskEnergy recommends a 14 percent reduction in its Gas Consumption Charge from $0.2338 per cubic metre ($6.32/GJ[1] at 36.98 GJ per thousand cubic metres) to $0.2014 per cubic metre ($5.45/GJ) effective November 1, 2001. The corresponding decrease in the annual bill of a typical residential customer would be $112 or 10 percent. Other sales customer classes would have average annual bill decreases of 10 to 11 percent.

The new rate is based on the forecast cost to SaskEnergy of the natural gas that it will resell to customers, plus the refund to customers of a forecast credit balance of $10.1 million in the Gas Cost Variance Account ("GCVA") at the end of October 2001. The Application also anticipates that, with the proposed rate, a $13.8 million debit balance owing to the Utility will build up in the GCVA by the end of October 2002.

The Saskatchewan Cabinet directed SaskEnergy to implement the proposed Gas Consumption Charge of $0.2014 per cubic metre on November 1, 2001, prior to the review of the Application. SaskEnergy implemented the rate change on an interim basis, with any rate adjustments from the review of the Application by the Saskatchewan Rate Review Panel ("the Panel") to be effective January 1, 2002.

The previous Gas Consumption Charge of $0.2338 per cubic metre went into effect June 1, 2001 as the result of an application that SaskEnergy made in May 2001 (the "June Application"). It replaced a rate of $0.1669 per cubic metre, and increased a typical residential annual bill by 24 percent. The proposed rate for 2001/02 is still somewhat higher than the rate that was in effect during the winter of 2000/01.

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1 A gigajoule ("GJ") is a unit of energy. A terajoule ("TJ") is one thousand gigajoules. A Petajoule ("PJ") is one million gigajoules. One GJ is about the amount of energy contained in 27 cubic metres or 950 cubic feet of natural gas, or 29 litres of gasoline, or 278 kilowatt hours of electricity, or 0.16 barrels of oil. The amount of natural gas used by individual residential customers varies widely; a typical residential customer consumes about 130 GJ annually for heating and hot water.

This review is to determine if SaskEnergy's contracting plans ensure that customers receive adequate supplies of natural gas at a price that is reasonable considering the opportunities available in the competitive market, and to confirm the rate that results from SaskEnergy's gas purchases.

1.2 North American Natural Gas Prices

The rapid rise in natural gas commodity prices over 1999 and 2000 was a North American phenomenon resulting from strong demand growth in the United States and limited supply. There were many reasons for the tightness in the natural gas markets including: reduced exploration and drilling activity prior to 1999 when commodity prices were low, new demands for natural gas-fired thermal-electric generation, weather, strong economic growth, and higher crude oil prices.

The factors that caused the increase in gas prices reversed in early 2001. The recent sharp price decline is due to the strong rate of refilling underground gas storage in the United States and Canada during 2001. The higher injection rate has been made possible by increased supply resulting from more well drilling, mild but not overly hot weather, and demand reductions resulting from higher gas prices and a slowing United States economy. Spot prices are now at approximately the level they were two years ago.

The quickness and magnitude of the increase in gas prices in late 2000, and the sharp drop in prices in 2001, were unexpected. High price volatility in response to relatively small changes in the supply/demand balance is expected to continue to be a characteristic of gas markets. Prices for 2001/02 will be strongly influenced by weather, the level of economic activity in the United States and Canada and the results from current drilling programs. Longer term, supply and demand fundamentals indicate some firming from current price levels.

1.3 SaskEnergy and Its Gas Distribution Activities

SaskEnergy is a provincial Crown Corporation operating under the SaskEnergy Act. SaskEnergy has a number of wholly-owned subsidiaries, each operating on a stand-alone basis. One subsidiary is TransGas Limited ("TransGas") which owns and operates natural gas transmission, gathering, compression, treatment and storage facilities in Saskatchewan. TransGas has an exclusive right to transport gas within the province, up to the town border stations where pressure reduction first occurs.

SaskEnergy, as the distribution utility, has the exclusive right to distribute gas within Saskatchewan. It delivers gas to approximately 317,000 residential, farm, commercial and industrial customers. Although the facilities of SaskEnergy start at the town border stations, its rates start with gas at the TransGas Energy Pool ("TEP"). TEP is a notional location part way through the TransGas transmission system, which acts

as a market hub or interchange point. SaskEnergy contracts with TransGas for gas storage and for transportation capacity from TEP to the SaskEnergy system for its utility sales customers, and also for those customers who buy gas directly from other suppliers but use load-shaped and balanced SaskEnergy delivery service. The TransGas transportation and storage costs are recovered from customers in SaskEnergy's Delivery Charges, along with SaskEnergy's costs of providing distribution delivery service.

With the development of competitive gas commodity markets since 1985, most industrial and some commercial customers now buy the natural gas commodity directly from a producer or other supplier and use only distribution services from SaskEnergy. Sales of the gas commodity by SaskEnergy now represent only about one-half of total SaskEnergy deliveries. SaskEnergy purchases natural gas for its remaining sales customers, and contracts for the transport of the gas to TEP, the notional receipt point for its delivery rates. The cost of buying the gas commodity and transporting it to TEP for the remaining sales customers is recovered in the Gas Consumption Charge. In 1998, SaskEnergy redesigned its rates and bills to show the Delivery Charge and the Gas Consumption Charge separately.

1.4 Approval of Rates

SaskEnergy and TransGas establish rates, charges, and terms and conditions of service for the services that each company provides to its customers. Each company must describe all rates and conditions of service in a schedule that is available to the public. The rates are subject to approval by the Saskatchewan Cabinet.

A Minister's Order dated July 27, 2000, pursuant to The Government Organization Act, established the Saskatchewan Rate Review Panel as a Ministerial Advisory Committee to review and provide an opinion on the fairness and reasonableness of proposed Crown Corporation rate changes. The Panel is to consider the interests of the customer, the Crown Corporation and the public in its opinions.

A subsequent Minister's Order, dated October 12, 2001, requested that the Panel review SaskEnergy's Application for a change to its Gas Consumption Charge for the period November 2001 through October 2002, and set out Terms of Reference for the review. The Terms of Reference stated that several matters, including the current operating rate structure, approved capital allocation, annual rate of return target, rate base, corporate policies, existing service level, and the methodology to allocate cost of service among rate classes, were to be considered as given. Where the Panel's recommendations differ from SaskEnergy's proposed rate change, the Panel also must explain how, in its opinion, implementation of the rate recommendations will allow SaskEnergy to achieve the rate of return and other parameters that are to be considered as given. The Panel is to present its report to the Minister of Crown Investments Corporation of Saskatchewan by December 14, 2001. The two Minister's Orders are Attachment 1 to this Report.

1.5 Purpose of BCUC Staff Review Report

The staff of the British Columbia Utilities Commission ("BCUC") were engaged by the Panel to provide recommendations to it regarding the fairness and reasonableness of SaskEnergy's proposed rate decrease and the disposition of the GCVA, consistent with the Terms of Reference for the Panel's review of the Application. BCUC staff act as independent advisors to the Panel to assist it in providing recommendations to government with respect to the rate decrease. This Report sets out the results of the BCUC staff review.

Attachment 2 of the Report outlines the services to be provided by BCUC staff. Attachment 3 describes the normal role of BCUC staff, outlines the delivery charge and gas commodity charge approval process in British Columbia and provides biographies for staff members Brian Williston and Bill Grant who prepared the Report.

2.0 LOAD FORECAST

2.1 Annual Load Forecast

SaskEnergy forecasts the following sales and purchase volumes for 2001/02 (Application, Chapter 4). To derive its annual load forecast, SaskEnergy multiplied the expected annual use per customer for each customer class under normal weather conditions times the expected average number of customers in each rate class. The assumed use per customer is based generally on weather adjusted data for the past three to five years. SaskEnergy notes that a trend of declining use per residential customer continues to be evident. Based on the average normalized residential use per customer over the past three years, SaskEnergy forecasts 128.3 GJ per customer for 2001/02, a 1.6 percent decline from the previous year.

Actual and Forecast Annual Sales and Purchases, TJ

	November 2000 through October 2001*	November 2001 through October 2002
SaskEnergy Sales	63,241	61,326
Swan Valley	11	122
Other Sales	2,888	0
Load Adjustment	(22)	0
Total Sales	66,118	61,448
SaskEnergy Usage	520	450
TransGas Fuel and Loss	363	183
Total Purchases	67.001	62,081

* Actuals November 2000 to August 2001. forecast September and October 2001.

SaskEnergy sells a small amount of gas to its subsidiary Swan Valley Gas Corporation ("Swan Valley") for customers in Manitoba. The gas is priced at SaskEnergy's Gas Consumption Charge. SaskEnergy also recovers an allocated portion of its storage payments and other costs from Swan Valley.

Due to warmer than normal weather in early 2001, larger than expected volumes remained in storage at the end of the heating season. This caused SaskEnergy to have a surplus of gas, which it sold into the market over the summer.

The corresponding SaskEnergy sales volume forecast for 2001/02 in the June Application was 65,143 TJ. SaskEnergy reduced its load forecast by 3,695 TJ primarily as a result of the migration of commercial customers to other gas commodity suppliers. Customers who wished to change suppliers for 2001/02 without a penalty, were required to give notice by August 1, 2001. Consequently, the risk of further migration of customers in 2001/02 is minimal.

2.2 Design Peak Day Forecast

SaskEnergy's peak day forecasting methodology was revised for 2000/01, and the forecast results were consistent with actual loads during cold weather in December 2000. The forecast peak day load is derived as the product of the forecast use per customer on the peak day and the estimated number of customers on that day. The forecast use per customer on the peak day is based on a regression analysis of the relationship between peak day use per customer and weather (temperature and wind). The regression uses historical data from the past 10 years to estimate the use per customer for weather conditions with a 1-in-20 probability of occurring in the test year. This is consistent with the design criteria used by gas utilities elsewhere.

SaskEnergy forecasts a design peak day load of 603.0 TJ for 2001/02, which is the same as the forecast for 2000/01, and the forecast for 2001/02 in the June Application. Suppliers who sell the gas commodity directly to customers will provide 15.0 TJ/d of the total peak supply.

2.3 BCUC Staff Assessment

The Gas Consumption Charge is intended to flow-through SaskEnergy's cost of purchasing gas, with any differences between forecast and actual accumulating in the GCVA. Consequently, the accuracy of the annual load forecast is not as critical as it would be if the Utility's Delivery Charges were under review. Based on a limited review and comparison to SaskEnergy's forecast for 2000/01, BCUC staff consider that the 2001/02 annual forecast should be accepted as reasonable.

It appears that SaskEnergy thoroughly analyzes and monitors its peak day requirements. Consequently, the design peak day forecast appears reasonable, and should also be accepted.

3.0 SUPPLY PORTFOLIO

Saskatchewan and SaskEnergy are in a favourable position to arrange a secure, flexible and relatively low cost supply of natural gas for consumers. Production within Saskatchewan exceeds consumption and Trans Canada Pipeline crosses the province carrying mainly Alberta gas production to market. The Alberta Energy Company ("AECO") gas trading point in Alberta is very liquid, and provides a reliable market reference price along with opportunities for financial price risk management activities. Moreover, AECO prices are expressed in Canadian dollars.

Perhaps most importantly, SaskEnergy has access to underground gas storage in old gas fields and caverns that are conveniently located close to its major markets. The Utility relies on storage gas to meet about two-thirds of its design peak day demand. Saskatchewan consumers benefit greatly from the available storage in proximity to load requirements.

3.1 Contracted Gas Supply

SaskEnergy designs its gas supply portfolio to give the least cost mix, while providing the required security and flexibility of supply (Application, Chapter 5). The Utility relies mainly on storage gas and gas purchase contracts to supply daily sales demand. SaskEnergy anticipates buying a small amount of spot gas to provide flexibility and to handle very cold weather. With ready access to liquid gas markets, such gas should be available for purchase when needed, although the price may be high.

In addition to meeting annual and peak day demands, the Utility carefully monitors weather and storage levels during the November through March winter period, when most gas is sold. To the extent the weather is colder than average and sales are higher, SaskEnergy will buy additional winter spot supply. On the other hand, if sales are lower, the Utility may sell the surplus in the marketplace or keep it in storage.

SaskEnergy buys most of its gas supply under year-round contracts that are medium term (term of 1 to 5 years) and long term (term greater than 5 years). The portion of total purchases that the Utility expects to acquire in Saskatchewan has increased to virtually 100 percent for 2001/02, as current market price differentials favour this shift. Reviews of previous Commodity Rate Applications have confirmed that detailed contract information support the schedules in the applications, and so BCUC staff have not reviewed details about individual supply contracts for 2001/02.

SaskEnergy's gas purchase contracts generally have annual price reopeners. A small number of contracts have fixed pricing, while prices for the large majority of purchases are referenced to the AECO monthly index. Natural gas price differentials for deliveries at Saskatchewan field points and at the TEP interchange point relative to the AECO index, are established by negotiation between market participants, and reflect supply and demand considerations as well as transportation costs. SaskEnergy is active in the marketplace and follows these price differentials closely.

3.2 Price Risk Management

Prior to 2000/01, SaskEnergy established its Gas Consumption Charge as a gas sales rate that was fixed for one year. Unlike several other gas utilities in Canada, until November 1999 it did not have a gas cost variance account in which to record differences between forecast and actual gas costs. To reduce the price risk from its AECO index-based purchases, the Utility used financial instruments to convert most of its index-based purchases to fixed pricing. SaskEnergy also purchased call options, which limited its upward cost exposure. In advance of the start of each gas year, the Utility established a fixed price for its gas purchases that reflected the average of the market price expectations, and which was the basis for the fixed gas commodity rate for the year. This approach allowed SaskEnergy to shield customers from volatile gas prices, and also generally delayed the impact on rates of rising gas prices.

Natural gas prices were trading at record high levels in Western Canada and across North America as the 2000/01 gas contract year approached. SaskEnergy fixed the price of a portion of the gas in its portfolio for 2000/01, and entered into some option arrangements. These activities plus the gas that was in storage secured about one-half of the supply for 2000/01 at prices that were well below market prices. However, SaskEnergy was concerned about the very high price levels and extreme price volatility, and consequently maintained a significant portion of indexed prices in its portfolio. Cold weather in November and December 2000, combined with the market's concern about the adequacy of storage levels, led to very high prices for the unhedged portion of purchases. This caused a $75.9 million debit balance to accumulate in the GCVA to the end of May 2001, which the Saskatchewan Cabinet directed SaskEnergy to absorb.

For 2001/02, the Utility extensively hedged its purchases by buying call options to set a cap price. The options were consistent with SaskEnergy's strategy to provide upward price protection and to also provide price participation on the downside, as they permit SaskEnergy and its customers to benefit from market prices if they fall below the cap. Some of the call options were associated with the sale of put options, to provide a "costless" collar for a portion of the hedges. Premiums from the sale of put options offset some of the cost of the call options, but the put options established a floor price for the related gas purchases. As gas prices declined sharply in the summer, SaskEnergy resold some of the call options, and entered into financial swaps that converted indexed prices to fixed prices. Some of the swaps were for AECO prices.

while others involved New York Mercantile Exchange ("NYMEX") prices. The NYMEX price swaps were used to provide price diversity. SaskEnergy hedged the basis differential between AECO and NYMEX for part of this volume, and also hedged its currency exchange exposure.

The overall result of these transactions is that approximately 84 percent of purchases in 2001/02 will be at fixed prices, while about 16 percent will float with market prices. However, as a portion of the gas purchased in summer 2002 will go into storage for sale the following year, SaskEnergy's 2001/02 gas costs will reflect only about 10 percent of increases or decreases in gas prices compared to forecast. If market prices begin to rise, SaskEnergy intends to hedge most of the remaining unhedged portion.

3.3 BCUC Staff Assessment

SaskEnergy has developed a portfolio of physical gas supply contracts for 2001/02 that is generally appropriate to meet the needs of its customers at a reasonable overall cost, considering its location and the opportunities available. Although the analysis that established the detailed makeup of the portfolio has not been reviewed, it is felt that such further review is not warranted. The arrangements that are in place for 2001/02 appear reasonable and the Utility is in the best position to optimize its portfolio. A regulator should not want to intrude on a utility's management function beyond what is necessary to assure the public that efficient operations exist. Furthermore, the preferred time to review the makeup of the supply portfolio is before gas supplies are contracted.

The negotiated prices for the great majority of gas purchase contracts rely on the AECO index, which is a reliable indicator of market prices. The basis differentials relative to this index seem reasonable.

The financial hedging actions of the Utility for this contract year indicate a need for the regulator to provide input at the planning stage, rather than only through after-the-fact prudency reviews. SaskEnergy successfully hedged the price of gas purchases for several years in the past. The hedging strategy for 2001/02 was developed and implemented during a time of very high gas prices and extreme price volatility. In those circumstances, SaskEnergy appears to have concentrated on protecting customers from further large increases in rates, with a corresponding reduced ability to benefit from lower market prices. A hedging objective to dampen rate volatility delays the impact of gas price increases, but likewise defers the effect on rates of market price decreases. SaskEnergy's fixed price hedges and option payments have the effect that a comparatively small part of the recent drop in gas prices is reflected in the proposed Gas Consumption Charge for 2001/02.

The Terms of Reference direct the Panel to consider the reasonableness of the proposed rate decrease in the context of SaskEnergy's gas purchase contracts, transportation costs, gas commodity market conditions at

the time of SaskEnergy's contractual commitments and the disposition of the GCVA balance. The Utility's gas contracting strategy, along with its price risk management objectives and strategy, are generally outside the scope of the review. Nevertheless, considering the impact these actions can have on gas costs and rates, and as discussed in its May 28, 2001 Report, BCUC staff are of the view that greater regulatory oversight of the Utility's gas contracting and price risk management strategy prior to implementation would be appropriate. A gas supply and price risk management plan should be developed in the context of the historical and expected market environment. The hedging component of the plan should address such matters as risk management objectives, the portion of purchases to be hedged, when hedges are to be put in place, the financial instruments to be used, the extent of dynamic trading of hedging instruments that is acceptable, credit-worthiness limits for counter-parties, and the front office/back office accounting structure that is in place to confirm the recording of transactions.

The filing of gas supply and price risk management plans with the Panel should supplement rather than replace oversight of gas procurement activities by the Utility's management and Board of Directors. Nevertheless, such filings and reviews are expected to help ensure that gas procurement objectives and strategies align with the interests of customers, the Utility and the public. While recognizing that the regulatory role of the Panel is somewhat unique, BCUC staff recommend that the Panel implement such a process for SaskEnergy for the 2002/03 gas contract year.

4.0 FORECAST COST OF GAS

The sales load forecast under average weather conditions and the portfolio of gas purchase contracts and financial hedges, were used to estimate the forecast 2001/02 Cost of Gas Sold of $358,388,000 (Application, Chapter 1). The Application assumes an AECO index price of $3.00/GJ for the year. Appendix 1 compares this forecast for 2001/02 to the forecast in the June Application and to actual/projected numbers for 2000/01.

SaskEnergy has requested that detailed proprietary information about its supply arrangements be kept confidential, as disclosure would disadvantage the Utility and its customers. This request for confidentiality of commercially sensitive information is consistent with disclosure requirements in other provinces where commodity competition exists.

4.1 Cost of Gas Purchases

SaskEnergy revised the format of the schedules that support the forecast Cost of Gas Sold. The present format is more consistent with SaskEnergy's current portfolio of supply contracts and price hedges, and clarifies the off-system transportation charges that are recovered in the Gas Consumption Charge.

Contracts with AECO Pricing and Price Differentials to AECO

Almost all of SaskEnergy's gas purchases have pricing that is referenced to the AECO index, plus a negotiated basis differential to adjust the price to the actual point of receipt of the gas. The new Application format uses the average forecast basis differential for the receipt point and a forecast of AECO prices to calculate the forecast price and gas cost at each receipt point. Differences between forecast and actual differentials should be small and will be recorded in the GCVA.

Fixed Price Contracts and Fixed Hedges

SaskEnergy buys a small amount of gas under fixed price contracts. SaskEnergy also uses financial instruments to convert a portion of AECO pricing to fixed prices using AECO or NYMEX price swaps. The prices for these purchases are known for the forecast period.

Options

For a substantial portion of its gas purchases with AECO pricing for 2001/02, SaskEnergy purchased call options to limit the cost exposure if prices increase. SaskEnergy also sold put options, which established a gas price floor. When forecast prices are above the "strike" or reference price for a call option, or below the strike price for a put option, the option acts to fix the cost of gas to SaskEnergy at the strike price. Based on its price forecast, SaskEnergy estimates the hedging benefit or cost that those options provide.

The option premiums that SaskEnergy paid to buy call options or received when it sold put and call options are also included in the Cost of Purchase Gas. Interest charges related to option premium costs and revenue are included under Operating Expenses and Interest for 2001/02.

There is risk in any price forecast, particularly in this period of extremely volatile market prices. Differences between forecast and actual costs will be recorded in the GCVA. BCUC staff consider that the forecast in the Application is a reasonable estimate of the cost of gas purchases in 2001/02, including hedging costs, assuming an AECO price of $3.00/GJ.

4.2 Transportation Costs

SaskEnergy contracts TransGas transportation service for moving gas to the TEP interchange point from Saskatchewan field receipt points or interconnects at the Saskatchewan/Alberta border. The Utility has reduced the amount of TransGas service for 2001/02, as it will be buying more gas at TEP. The amount of service contracted for 2001/02 corresponds to expected Saskatchewan field purchases and spot gas purchases. SaskEnergy pays for the service at TransGas' current published tariff rates, which have been approved by the Saskatchewan Cabinet and will be frozen until December 31, 2001. An assessment of the level of current TransGas rates is outside the scope of this Report.

In the past, SaskEnergy also contracted for TransCanada Alberta (previously Nova Gas Transmission Division) transportation service to the Saskatchewan border, and paid rates approved by the Alberta Energy and Utilities Board for the capacity. For 2001/02, SaskEnergy will not purchase long or medium term gas in Alberta and the TransCanada Alberta service contract will be permitted to expire at the end of 2001. Expiry of the TransCanada Alberta service contract will reduce costs by $2.0 million for 2001/02.

SaskEnergy appears to be carefully managing the amount of transportation that it contracts for.

4.3 Change in Storage Inventory Value

Gas injected into storage is valued at the average cost of acquiring the gas that month at the TEP interchange point. This cost includes gas purchase costs including hedging effects and the cost of transportation to TEP. Gas withdrawn from storage is priced at the average cost of gas in inventory.

Gas costs are expected to be slightly higher next summer than they were this past summer. The somewhat higher cost of gas to be stored in the summer of 2002 means that the value of gas in storage is anticipated to increase slightly over the gas year. This results in a reduction in the gas costs to be recovered from customers in 2001/02. The cost reduction has been appropriately recognized by SaskEnergy in the Application.

4.4 Internal SaskEnergy Usage

SaskEnergy uses some gas for the operation of its distribution system. It buys this gas as part of its supply procurement, and recovers the cost of the gas through its Delivery Charges. The cost of Internal Usage gas is deducted from the cost of gas purchases, with the credit calculated at the average cost of gas, including transportation to the TEP interchange point.

For 2001/02, SaskEnergy forecasts 450,000 GJ of gas valued at $2,628,000 as Internal Usage. BCUC staff consider that the forecast is reasonable.

4.5 Operating Expenses and Interest

In order to maintain an equitable balance of costs between Utility sales and delivery service for directly purchased gas, SaskEnergy includes costs that are related to gas procurement and management in the Gas Consumption Charge. For 2001/02, these costs are forecast as follows:

	2000/2001 Actual/Projected	2001/2002 June Application	2001/2002 Application
OM&A and Overhead	$ 1,063,000	$ 1,063,000	$ 1,063,000
Depreciation and Corporate Capital Tax	250,000	250,000	250,000
Net Bad Debt/Late Payment Fees	(169,000)	(248,000)	(169,000)
Interest on Gas in Storage and Option Premiums	2,610,000	5,820,000	4,841,000
Other Interest	40,000	40,000	40,000
	$ 3,793,000	$ 6,925,000	$ 6,025,000

Interest costs are calculated using SaskEnergy's short-term borrowing interest rate. The higher cost of gas in storage contributes to the increase in interest costs for 2001/02, but the main cause is interest related to option premiums. Interest costs in the Application are lower than in the June Application, since forecast gas prices for 2001/02 are currently lower than they were in June. The net bad debt and late payment fee credit in 2001/02 is forecast to be the same as the actual/projected amount for 2000/01.

BCUC staff support including these costs in the Gas Consumption Charge for Utility sales customers, to ensure that the Utility competes fairly with other gas marketers. The cost forecast for 2001/02 is considered to be reasonable.

4.6 BCUC Staff Assessment

As discussed in the preceding sections, BCUC staff accept the forecast Cost of Gas Sold of $358.388 million in the Application as reasonable, assuming an AECO price of $3.00/GJ for 2001/02. With the extensive hedging that is in place, actual gas costs will vary only modestly from the forecast with changes in market gas prices.

In response to a request from BCUC staff, SaskEnergy updated the forecast in the Application for a number of factors, including short-term interest rates, a $1.181 million increase in the GCVA credit balance at October 31, 2001 to $11.316 million, and actual gas prices for November 2001. Using actual gas prices for November 2001 and the $3.00/GJ gas price forecast in the Application for the remainder of 2001/02, the forecast 2001/02 Cost of Gas would go down by $135,000 to $358.253 million. Primarily due to the higher credit balance at October 2001, the GCVA debit balance at October 31, 2002 would decrease by $1.346 million to $12.479 million. The change to the forecast is not material, as differences between forecast and actual will be recorded in the GCVA. SaskEnergy did not refile the detailed schedules from the Application, and consequently the forecast in the Application has been used as the basis for this Report.

Forward gas prices for 2001/02 have increased somewhat since the Application was prepared. At the request of BCUC staff, SaskEnergy used actual November 2001 prices and November 14, 2001 forward prices for the remainder of 2001/02 to estimate a more current forecast of AECO prices that averages $3.74/GJ. Using this price forecast and the other updated information referred to in the preceding paragraph, the Cost of Gas Sold would increase by $5.602 million to $363.990 million, as shown in Appendix 1. BCUC staff consider that gas rates generally should reflect the most likely and most current price forecast, and recommend that this more recent forecast be considered when setting rates for 2001/02.

5.0 GAS COST VARIANCE ACCOUNT

The actual cost of gas can vary from forecast for a number of reasons. Gas that does not have a fixed price will be bought at actual market prices at the time of purchase. Load variations caused by weather will affect the proportions of purchased and storage gas supply that are sold. In addition, actual gas sales can be higher or lower than forecast, which will affect the gas commodity revenue from sales. Most gas utilities in Canada have a gas commodity cost deferral account in which to record differences between actual and forecast. SaskEnergy's Board of Directors approved the GCVA to be effective November 1, 1999.

SaskEnergy's GCVA records all cost of gas variances between actual gas costs and actual gas commodity sales revenue. That is, the GCVA is compensating not only for differences between the actual cost of gas and the forecast cost that is embedded in the rates, but also for differences in the volume of sales. BCUC staff consider that this form of deferral account is justified in order that SaskEnergy fully recovers its prudently incurred actual costs of providing the gas commodity to customers, without a mark-up.

The actual commodity cost of gas recorded in the GCVA includes all cost items in the Commodity Rate Application. Interest expense for gas in storage is being recorded in the account. This is consistent with the current Delivery Charges, from which storage gas interest costs were excluded. SaskEnergy confirmed

that the Operating, Maintenance and Administration expenses and Depreciation charges recorded in the GCVA are only those costs and overhead that are directly related to gas supply. Swan Valley gas sales are treated as part of the distribution utility's load, but otherwise no costs related to non-distribution utility activities are included.

Commodity revenue recorded in the GCVA includes actual commodity revenue from the Gas Consumption Charge, revenue from excess gas sales and late payment charges. The Utility uses its short-term borrowing interest rate to calculate interest charges on the GCVA balance, whether the balance is owing to customers or to SaskEnergy.

A GCVA credit balance (an amount owing to customers) is credited to customers as part of a subsequent rate adjustment. A GCVA debit balance (an amount owing to SaskEnergy) is also normally recovered as part of a subsequent rate adjustment. When the GCVA balance exceeds $20 million, SaskEnergy can apply for an adjustment to the Gas Consumption Charge.

5.1 GCVA Balances

The GCVA had a debit balance of $75.9 million at the end of May 2001. The Saskatchewan Cabinet directed SaskEnergy to absorb this balance, resulting in a zero account balance on June 1, 2001 (Application, Chapter 2). The Application projects the balance at October 31, 2001 will be a credit owing to customers of $10.1 million. (A more recent estimate of the credit balance is $11.3 million.) The Application includes a detailed analysis of the factors that contributed to the balance that accumulated over the five-month period, as follows:

GCVA Balance June 2001 – October 2001, Millions of Dollars

Lower gas prices	$ 12.0
Loss on sales of surplus gas	(3.3)
Adjustment for billing at June 2001 rate	1.2
Interest and Other	0.2

The Application projects a GCVA debit balance of $13.8 million at the end of October 2002, based on the proposed Gas Consumption Charge and the forecast AECO price of $3.00/GJ. (A more recent estimate of the debit balance is $12.5 million.) As shown on Appendix 1, using the forecast in the Application, a Gas Consumption Charge of $0.2096 per cubic metre would be needed to project a zero GCVA balance at October 2002. This would result in a 7 percent reduction in customer bills, rather than 10 percent as proposed.

As discussed in section 4.6, SaskEnergy used a more current price forecast of $3.74/GJ and other updated information to recalculate the forecast Cost of Gas Sold for 2001/02. With the Gas Consumption Charge proposed by SaskEnergy, the expected GCVA debit balance at October 31, 2002 would increase from $13.8 million to $18.3 million, as shown by the following table.

Projected GCVA Balances, Millions of Dollars

	Application	November 14, 2001 Forecast
Balance July 1, 2001	0.000	0.000
Recoveries, June 2001 to October 2001	10.088	11.316
Interest, June 2001 to October 2001	0.046	*
Balance October 31, 2001	10.134	11.316
Recoveries, November 2001 to October 2002	(23.755)	(29.661)
Interest, November 2001 to October 2002	(0.223)	*
Balance October 31, 2002	(13.844)	(18.345)

* Recoveries and interest are combined, as detailed information is not available.

At the request of BCUC staff, SaskEnergy also used November 14, 2001 forward prices for the 2002/03 gas year that average $4.62/GJ to forecast the effect on GCVA balances in 2002/03. Assuming that gas prices remain at the forecast level and the proposed Gas Consumption Charge continues in effect, the GCVA debit balance of $18.3 million at October 2002 would improve to a credit balance of about $4 million by October 2003.

5.2 BCUC Staff Assessment

SaskEnergy appears to be administering the GCVA generally as anticipated. The Application states that SaskEnergy will request the Provincial Auditor to perform an audit of all transactions related to the GCVA balance to the end of October 2001. As a result, BCUC staff have limited their review of the GCVA balance to the information that was in the Application.

SaskEnergy reports the status of the actual GCVA balance to the Panel on a quarterly basis. Considering the current extreme volatility of gas prices, BCUC staff recommend that SaskEnergy make several changes to the report that would help the Panel to monitor the GCVA and the appropriateness of current rates. Each quarterly report should include a forecast of gas costs and revenue, and GCVA balances, for the following 12 months. The forecasts could be in summary form, and could omit many of the supporting details unless a rate change is proposed. A 12-month period is recommended in order to avoid seasonal effects, and to provide a reasonable level of rate stability. Also, this information should be filed prior to the start of the

12-month period, so that SaskEnergy and the Panel can evaluate whether the rates that are in effect should continue. It is recognized that filing the reports prior to the start of each period will require SaskEnergy to report projected rather than actual GCVA balances.

When gas prices are highly volatile as they are at present, there is increased risk that changing circumstances will cause large balances to accumulate in the GCVA. The present $20 million criterion to apply for a rate change is 5.6 percent of the forecast Cost of Gas Sold for 2001/02. The criterion could be more broadly expressed as a forecast GCVA balance of $20 million or a 5 percent difference between forecast gas costs and revenue over a 12-month period. BCUC staff recommend the development of guidelines that would permit SaskEnergy and the Panel to quickly implement a change to the Gas Consumption Charge in response to changing circumstances, with the rate change to be reviewed subsequently if necessary.

6.0 GAS CONSUMPTION CHARGE

SaskEnergy recommends a 14 percent reduction in the Gas Consumption Charge for 2001/02, which would reduce customer bills by approximately 10 percent. Based on the gas cost forecast in the Application, this would result in a GCVA debit balance at October 31, 2002 of $13.8 million. Using more current forward gas prices and other updated information, SaskEnergy projects a $18.3 million GCVA debit balance at October 2002.

SaskEnergy's recommendation of a 10 percent rate reduction is somewhat aggressive, but appears reasonable. Although gas prices for 2001/02 are extremely volatile and difficult to predict with any confidence, the Utility has entered into a hedging program that has eliminated most of the exposure to market price movements and will prevent the build-up of a very large GCVA balance. Also, SaskEnergy anticipates that current high storage inventories, increased supply and reduced demand due to lower economic activity may cause prices to soften further for the 2001/02 contract year. Moreover, BCUC staff note that during 2001/02, there is minimal risk of further loss of load due to customers choosing to buy the gas commodity from other suppliers.

The Application identifies that SaskEnergy can request a rate increase if the GCVA balance exceeds $20 million. However, BCUC staff anticipate that, assuming gas prices remain reasonably near current levels, a 12-month rolling forward assessment of GCVA balances is unlikely to indicate a rate change is required. For example, a quarterly report for February 2002 should look at gas costs and revenue for the following 12 months, and SaskEnergy has not hedged purchases beyond October 2002. If current low gas prices continue, gas costs and revenue for the 2002/03 gas year are forecast to more than offset the projected $18.3 million GCVA debit balance at October 2002.

The Panel is required to consider the interests of the customer, the Crown Corporation and the public. The Gas Consumption Charge proposed by SaskEnergy is consistent with the reasonable expectations of customers for a significant rate reduction due to current lower gas prices. If there are large gas price increases and circumstances warrant, SaskEnergy can apply for a rate change. In any case, the GCVA will record any differences between actual gas costs and the revenue that is generated by approved rates. In this way, customers will pay the actual cost of buying gas for them, and SaskEnergy will be allowed to achieve the performance inherent in the parameters that are stated as given in the Minister's Order.

6.1 BCUC Staff Recommendations on Gas Consumption Charge

BCUC staff are of the opinion that the Gas Consumption Charge of $0.2014 per cubic metre proposed in SaskEnergy's Application is fair and reasonable, and recommend that the rate be approved effective November 1, 2001. This recommendation includes acceptance of SaskEnergy's proposal to refund the credit balance in the GCVA at October 2001 to customers, and to accumulate a GCVA debit balance over the 2001/02 gas year that is expected to be less than $20 million.

BCUC staff also recommend that the Panel:

- Request SaskEnergy to file its quarterly reports on GCVA balances 15 business days prior to the start of the period, and to include a forecast of gas costs and revenue for the following 12 months.
- Request that SaskEnergy, in the event that forecast gas costs (including the GCVA balance at the start of the period) and revenue for the following 12 months differ by more than 5 percent, apply for a rate change. The Panel may wish to seek prior approval of the Saskatchewan Cabinet to implement such applied-for rate changes on an interim basis, subject to review upon a direction to do so in a Minister's Order.
- Request SaskEnergy to file with the Panel its Gas Supply and Price Risk Management Plan for 2002/03, setting out the Utility's strategy for buying a sufficiently reliable supply of gas at the lowest possible overall cost, prior to entering into significant new supply contracts or hedges for this period. The Plan would normally be expected to be filed by the end of March each year.

This Report is submitted as of December 10th, 2001.

J.B. Williston, Manager
Engineering and Commodity Markets

W.J. Grant, Executive Director

SaskEnergy Incorporated

Cost of Gas Sold
(in $ 000's)

	2000/01 Approved	2000/01 Projected	2001/02 June Application	2001/02 November Application	2001/02 Nov. 14, 2001 Forecast[1]
Cost of Purchase Gas	303,915	408,938	471,415	353,223	362,578
Transportation Costs	13,480	6,661	2,745	2,970	2,957
Net Change in Storage Inventory	(26,939)	(44,980)	(17,272)	(1,202)	(4,797)
Subtotal	290,456	370,619	456,887	354,991	360,738
Cost of Other Gas Sales	0	0	0	0	0
Deduct Cost of SaskEnergy Internal Use	(2,116)	(2,994)	(3,182)	(2,628)	(2,673)
Cost of Gas	288,340	367,625	453,705	352,363	358,065
Operating Expenses and Interest	3,735	3,793	6,925	6,025	5,925
Cost of Gas Sold	292,075	371,418	460,630	358,388	363,990
GCVA Balance Recovery	(156)	0	0	(10,134)	(11,316)
Adjusted Cost of Gas Sold	291,920	371,418	460,630	348,254	352,674
Quantity Sold, PJ	64.6	66.1	65.1	61.4	61.4
Cost of Gas Sales, $/GJ	4.52	5.62	7.08	5.67	5.74
Volume Available for Recovery, $10^6 m^3$	1748.9	1786.2	1,755.9	1,661.5	1,661.5
Gas Consumption Charge (Full GCVA Recovery[2]) $/m^3$	$0.1669			$0.2096	$0.2123
Gas Consumption Charge (Recommended) $/m^3	$0.1669		$0.2338[3]	$0.2014[4]	$0.2014[5]

1 November 14, 2001 Forecast uses GCVA credit balance of $11,316,000 at October 31, 2001, actual November 2001 gas prices, November 14 forward gas prices for the remainder of 2001/02 and other updated information.
2 Gas Consumption Charge to give zero GCVA balance at the end of the gas contract year.
3 Rate of $0.2338 per cubic metre was approved effective June 1, 2001.
4 SaskEnergy proposes a Gas Consumption Charge that gives an October 2002 GCVA debit balance of $13,844,000.
5 Proposed Gas Consumption Charge and November 14, 2001 Forecast gives an October 2002 GCVA debit balance of $18,345,000.

RECEIVED
JUL 31 2000
Clerk of the Executive Council

MINISTER'S ORDER

The Establishment of the Ministerial Advisory Committee Saskatchewan Rate Review Panel

I, John T. Nilson, Q.C., Minister of Crown Investments Corporation pursuant to section 16 of *The Government Organization Act* do hereby order that:

1. There shall be established a ministerial advisory committee known as the Saskatchewan Rate Review Panel (herein referred to as the Panel);

2. The Panel, as its mandate:

   (a) shall conduct a review and provide an opinion of the fairness and reasonableness of proposed Crown Corporation rate changes, referred to the Panel by the Minister of Crown Investments Corporation, considering the interests of the customer, the Crown Corporation, and the public; and

   (b) shall incorporate as part of its mandate specific terms of reference for particular Crown Corporation rate change reviews that may be attached by further minister's order.

3. Crown Corporation means SaskEnergy, SaskPower, and SGI AutoFund

4. The following persons are appointed as members of the Panel for a term not to exceed July 25, 2002:

Bob Lacoursiere	Saskatoon
Tracey Bakkeli	Regina
John Boan	Regina
Jo-Ann Carignan-Vallee	Assiniboia
Sheldon Craig	La Ronge
Joan Meyer	Swift Current

5. Bob Lacoursiere is designated as chairperson of the Panel;

6. In conducting its review, the Panel shall:

   (a) receive a rate change submission from a Crown Corporation;

   (b) establish procedures for conducting the review and ensure that these procedures are made available to the public;

   (c) engage the services of a consultant(s) to assist the Panel in its review of the fairness and reasonableness of the proposed rate change;

(d) make available to the public, prior to holding public meetings, the Crown Corporation rate change submission, with the exception of commercially sensitive information;

(e) hold public meetings and provide appropriate notification to the public of the date and location of public meetings, including any rules for public participation and Crown Corporation participation;

(f) provide members of the public with the opportunity to review and comment on the proposed rate changes to the extent reasonably allowed by the mandate of the Panel and by the schedule according to which the Panel is required to complete its work and provide its report to the Minister of Crown Investments Corporation;

(g) receive presentations of the consultant(s) or the Crown Corporation, review any written submissions and receive comments from the public;

(h) prepare a report on the Crown Corporation rate change submission for the Minister of Crown Investments Corporation after considering material received from the Crown Corporation, the consultant(s), the public, and its own analysis:

(i) where the Panel determines the rate changes as proposed are fair and reasonable, recommend that the changes be implemented; or,

(ii) where the Panel determines the rate changes are not fair and reasonable as proposed, recommend that the rate changes be adjusted providing reasons for this conclusion;

(i) provide its report respecting the proposed rate changes to the Minister of Crown Investments Corporation on a date set out in or within any time period after having received the rate change submission that is contained in specific terms of reference for particular Crown Corporation rate reviews; and

(j) make its report available to the public;

7. The Panel may utilize the services of such independent experts, clerks, reporters and assistants that are engaged on its behalf, as it deems necessary or advisable to aid and assist the Panel in its review;

8. Remuneration shall be paid to the panel members as follows:

(a) a retainer of $9,000 per annum and a per diem of $700 per day for the chairperson while engaged in the work of the Panel; and

(b) a retainer of $6,000 per annum and a per diem of $500 per day for the other members while engaged in the work of the Panel;

9. Panel members shall be reimbursed for traveling and expenses according to the approved Crown Investments Corporation policy outlined in the Remuneration Schedule and Expense Guidelines for Directors appointed to Crown Investments Corporation Subsidiary Crown Boards; and

10. Payment of remuneration, reimbursement and expenses incurred in the conduct and administration of the review shall be paid by Crown Investments Corporation.

Dated at the City of Regina, Saskatchewan, this 27th day of July, 2000.

Minister of Crown Investments Corporation

MINISTER'S ORDER

Saskatchewan Rate Review Panel
SaskEnergy Natural Gas Commodity Rate Change

WHEREAS by an Order dated July 27, 2000, issued pursuant to Section 16 *of The Government Organization Act*, the Minister of Crown Investments Corporation appointed a Ministerial Advisory Committee known as the Saskatchewan Rate Review Panel;

AND WHEREAS that Order provides for specific terms of reference for particular Crown Corporation rate change reviews to be attached by further minister's order;

AND WHEREAS it is desirable to establish terms of reference for a SaskEnergy rate change review and to attach the Terms of Reference to the previously mentioned Minister's Order;

NOW THEREFORE, I hereby amend the said Order by attaching Appendix A affixed hereto as **"Schedule G: SaskEnergy Natural Gas Commodity Rate Terms of Reference"** to the said Minister's Order.

Dated at Regina, Saskatchewan this 12th day of October, 2001.

Maynard Sonntag
Minister of Crown Investments Corporation

APPENDIX A

Schedule G:
SaskEnergy Natural Gas Commodity Rate Terms of Reference

Terms of Reference

The Saskatchewan Rate Review Panel is requested to conduct a review of SaskEnergy's interim rate decrease in its natural gas commodity rates which was implemented November 1, 2001. The Panel is requested to approve or provide recommendations for changing the rate for implementation on January 1, 2002.

The Panel shall provide an opinion of the fairness and reasonableness of SaskEnergy's proposed rate changes, considering the interests of the customer, the Crown Corporation and the public.

In conducting its review, the Panel will consider the following factors:

(A) The reasonableness of the proposed changes to the gas consumption rates in the context of:

1. SaskEnergy's anticipated cost of gas for the effective term;
2. the Gas Purchase Contracts entered into by SaskEnergy for the supply of gas;
3. the amounts SaskEnergy pays for the transportation of gas;
4. the natural gas commodity market conditions at the time of SaskEnergy's contractual commitments; and
5. the disposition of the balance of the Gas Cost Variance Account.

(B) In conducting its review, the Panel shall consider the following as given:

1. the current operating rate structure;
2. the approved capital allocation, annual rate of return target, rate base, and corporate policies;
3. the existing service level; and
4. the cost of service methodology and resulting study, which allocates SaskEnergy costs between the various rate classes.

The Panel will not publicly release or require SaskEnergy to publicly release commercially sensitive material including, but not limited to, its gas price hedging strategy and any details of its hedging or the gas purchase contracts.

However, the Panel may release the net effect of SaskEnergy's gas price hedging and gas purchase contracts.

The Panel must include in its report an explanation of how, in its opinion, implementation of the

Panel's rate recommendations will allow SaskEnergy to achieve the performance inherent in the parameters outlined in "B", where the Panel's recommendations are different from SaskEnergy's proposed rate changes.

The Panel will release, as part of its final report, the results of the review of SaskEnergy's rate request as conducted by an independent third party.

Conduct of the Review

The Panel will present its report to the Minister of Crown Investments Corporation no later than December 14, 2001.

Schedule "A"

Services Provided by BCUC

1. Provide professional and technical expertise, advice and services to the Panel pertaining to a review of SaskEnergy's interim rate decrease in its natural gas commodity rates which was implemented November 1, 2001.

2. Prepare and deliver to the Chair of the Panel a report on SaskEnergy's proposed rate changes. The report should:

   - review whether SaskEnergy's proposed rate changes are fair and reasonable;
   - provide a recommendation to the Panel regarding SaskEnergy's rate proposals; and
   - provide a recommendation to the Panel regarding the disposition of the Gas Cost Variance Account.

3. Attend meetings as required by the Chair of the Panel.

THE BRITISH COLUMBIA UTILITIES COMMISSION STAFF

General

The British Columbia Utilities Commission is an independent regulatory agency of the Provincial Government operating under and administering the Utilities Commission Act. The Commission's primary responsibility is the regulation of the 20 energy utilities and pipelines under its jurisdiction to ensure that the rates charged for energy are fair, just and reasonable, and that utility operations provide safe, adequate and secure service to their customers. The Commission approves the construction of new facilities planned by utilities and their issuance of securities. The Commission's function is quasi-judicial and its decisions and orders may only be appealed to the Court of Appeal on questions of law or jurisdiction. The Commission members are appointed for specific terms by the Cabinet, through the Lieutenant Governor-in-Council.

The Commission's professional staff are hired independently by the Commission under the powers of the Utilities Commission Act and are separate from the Public Service Act. Commission staff provide technical advice and administration support to the Commission in all areas including engineering, finance and accounting, economics and rate design, and review of commodity contracts. Bill Grant is the Executive Director of the Commission and the most senior staff position, reporting directly to the Chairperson. Brian Williston is the Manager, Engineering and Commodity Markets and is responsible for the review of natural gas and electricity supply contracting practices and of applications for major facility additions. Biographies are attached.

Revenue Requirements Application Review

In British Columbia, the Utilities Commission Act provides that the only rates a public utility can lawfully charge and the only terms and conditions of service that it can apply, are those which have been filed with and accepted by the Commission. Rates must strike a balance between being a fair charge for the service provided to the customer, while permitting the utility to earn a reasonable return on its investments required to provide these services.

A revenue requirements application generally compares, for a future test period such as the next year, a forecast of the revenue generated using current rates to a forecast of the utility's cost of providing service. The utility usually requests adjustments to customer rates to eliminate any forecast revenue deficiency or surplus. Utility costs such as operating, maintenance and administration expenses, depreciation charges, interest charges, income and other taxes, and a fair return on its equity investment, are typically recovered in

fixed Monthly Charges and variable Delivery Charges. Costs related to the gas commodity are flowed-through to customers without any mark-up by the utility, and are recovered in variable Gas Consumption Charges.

Rate design is the allocation of the utility's revenue requirement to individual rate classes of customers, and the structuring of the components of rates for each class. Rate design is generally reviewed less frequently than revenue requirements. Between rate design reviews, the Commission makes revenue requirement adjustments to rates in a manner that is consistent with the rate structure and specific directions that were approved in the last rate design proceeding.

A revenue requirement application for changes to delivery rates generally requires a public hearing. Because of the adversarial nature of the traditional public hearing process, hearings can become long and costly. The Commission has introduced the following approaches in an effort to reduce costs and save time:

Negotiated Settlement Process ("NSP")

NSP has been very successful by eliminating the need for a hearing on many applications and reducing the scope of matters that need to be reviewed in other cases. In the negotiation process, individuals representing various interests openly explore issues set out in the utility's application, with the purpose of reaching common understanding of the underlying interests. Recommended solutions and agreements are arrived at through collaboration and consensus. Trade-offs between competing objectives are encouraged so that the final settlement maximizes the overall needs of the participants. Commission staff are active participants to ensure that all ratepayers are represented. Settlements are subject to Commission approval.

Performance Based Regulation ("PBR")

PBR mechanisms are used to streamline rate setting, and to implement incentives to utilities to trim costs while maintaining high quality service. A PBR mechanism typically sets a baseline revenue requirement by expense category that can be modified for inflation, productivity and other factors in the future. Both customers and shareholders are rewarded for management measures that result in costs below the baseline. Costs, like taxes, that are beyond the control of the utility are recovered at cost. Service quality measures ensure that the utility does not pursue costs savings at the expense of system reliability, safety and customer satisfaction. PBR arrangements typically run for several years, with annual meetings to review progress and performance.

Other Processes

The Commission frequently uses workshops, pre-hearing conferences and town hall meetings as part of the hearing process. Workshops are educational sessions prior to a hearing, so that all parties have a similar level of understanding. Pre-hearing conferences optimize the hearing schedule, and attempt to identify non-contentious issues that may be removed from the scope of the hearing. Town hall meetings are less formal hearing sessions that are held at times, and in locations, which are more convenient for members of the public likely to be affected by the application.

Rather than an oral public hearing, the Commission sometimes uses a written hearing where the subject is technical and of limited interest to the public, or an Inquiry by a single Commissioner where the issue is fairly well defined and localized.

Generic Hearings

Where issues are common to several utilities, the Commission reviews the matter in a single generic hearing. This approach has been used to determine the appropriate rate of return on equity for the major utilities it regulates, and to develop a mechanism for calculating the return for future years.

Energy Supply Contract Review

In British Columbia, Section 71 of the Utilities Commission Act provides that the Commission must review and accept the commodity supply contracts entered into by each utility. The Commission must determine that the quantity of natural gas contracted for, and its availability, are sufficient for the needs of the core customers of the utility. The Commission must also determine that the prices in those contracts are competitive. In practice, Commission staff have an ongoing dialogue with the natural gas supply departments of the affected utilities to agree on a contracting plan early in each year and the Commission then accepts individual contracts that are consistent with the contracting plan. The utilities enter into a portfolio of natural gas contracts, including baseload contracts, peaking contracts, seasonal contracts, and underground storage contracts. BC Gas Utility Ltd. ("BC Gas") also stores gas in its liquified natural gas facility. The various contracts will include both variable priced and fixed priced contracts, and utilities have price risk management programs to attempt to obtain the lowest overall price for the customers.

British Columbia is not blessed with underground storage nearby the primary load centre in the Lower Mainland. This circumstance, coupled with the poor load factor of the residential and commercial

customers which make up the bulk of the utility core sales, results in contracting plans which are more diverse than may be necessary for a utility with local storage options.

In British Columbia each gas utility is permitted to flow-through its actual prudently-incurred cost of gas purchases to customers. Each utility has a gas cost variance account to record the difference between the actual cost of gas purchases and the revenues recovered through the gas commodity component of rates. Positive or negative balances in the account are passed through to customers in future rates. In specific instances, the Commission has approved phased-in commodity cost increases to avoid rate shock to customers. While this process has had the advantage of smoothing the rate increases to customers, it has been criticized as blunting the market signals to customers.

In response to the increase in gas prices in 2000, the Commission reviewed BC Gas Utility Ltd.'s, ("BC Gas") practices related to the setting of gas commodity rates and management of gas cost variance account balances. Commission Letter No. L-5-01, dated February 5, 2001, established "Guidelines for Setting Gas Recovery Rates and Managing the Gas Cost Reconciliation Account Balance". BC Gas files quarterly reports on gas costs and gas commodity revenue, and is expected to apply for a rate change if forecast costs and revenues for the following 12 months differ by more than 5 percent. The Commission did not change the three year amortization of the BC Gas gas cost reconciliation account balance at the end of 2000, but found that future amounts accumulated in the account should be amortized over 12 months in normal circumstances. The Commission has subsequently directed the other gas utilities in British Columbia to file quarterly reports on gas costs and revenue, and gas cost variance account balances.

WILLIAM JOHN GRANT, B.SC. (Eng.), MBA, CFA

Bill has been employed by the British Columbia Utilities Commission and its predecessor, the British Columbia Energy Commission, for more than 20 years. For the past 12 years he has been the Executive Director of the Commission. Prior to Commission employment he worked for Transport Canada and the Institute of Guided Ground Transport.

Bill has initiated or been involved in the development of many energy regulatory reforms including the following:

- Natural gas commodity competition and unbundling of utility tariffs. British Columbia was the first province to allow industrial customers to purchase gas directly from producers or marketers. The process of unbundling utility costs lead the Commission to initiate a bypass methodology which has been adopted by many jurisdictions;

- An automatic return on equity adjustment mechanism was first implemented in Canada by the Commission;

- The Commission has been using and refining its multi-year, performance-based rate making process over the past five years;

- The Commission has selectively used alternative dispute resolution techniques for more than ten years. Most utility rate and rate design applications are settled rather than going to public hearing; and

- The Commission first implemented wholesale electricity competition in 1996 and the first retail access application was approved in 1999.

Bill completed a Masters of Business Administration degree immediately following his undergraduate Bachelor of Science degree. He has been a Professional Engineer in Ontario and British Columbia and he returned to academic study to obtain a Chartered Financial Analyst designation from the University of Virginia. Bill enjoys skiing and mountain biking. He does not enjoy revenue requirements hearings.

JOHN BRIAN WILLISTON, P.Eng.

CAREER EXPERIENCE

British Columbia Utilities Commission

1997-01 Manager, Engineering and Commodity Markets
- Manage the engineering and energy commodity markets staff which support the regulation of natural gas and electrical utilities in British Columbia.

1992-97 Senior Petroleum Engineer
- Provided engineering support for the financial regulation of gas utilities and oil pipelines, with responsibility for energy supply contracts and market-based gas sales activities.

Williston Energy Management

1992 Principal
- Analyzed gas supplies available in British Columbia, and developed alternatives for connection of new supply areas to markets.

Canwest Gas Supply Inc.

1990-91 Vice President Operations and Transportation
- Responsible for ordering gas purchases and transporting gas marketed by the significant gas aggregator in British Columbia, including negotiating transportation contracts for deliveries throughout western North America.

British Columbia Petroleum Corporation

1989-90 Vice President Gas Supply
- Responsible for purchasing and transporting natural gas and marketing sulphur and liquid byproducts, including negotiation of new supply and service contracts.

1975-88 Chief Engineer, Senior Engineer
- Managed the engineering group, with responsibility for testing and forecasting of gas deliverability and production; economic evaluations and negotiations for new supply areas; and administration of gas purchase contracts. Earlier, evaluated feasibility of a grassroots oil refinery and petrochemical facility, and was Metric Coordinator for company.

Gulf Oil Canada Ltd.

1969-75 Process Engineer, Planning Analyst
- Provided technical support for oil refinery operations, designed and brought into service new and expanded facilitates. Optimized crude runs and operations to meet product demands.

EDUCATION, PROFESSIONAL ASSOCIATIONS

- B.Sc. in Chemical Engineering, University of New Brunswick, 1969
- Registered Professional Engineer in British Columbia
- Member of Society of Petroleum Engineers